No. 13109.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Mary Neil and William P. Neil,

Appellants,

vs.

United States of America,

Appellee.

REPLY BRIEF FOR APPELLANTS.

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TABLE OF AUTHORITIES CITED

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I.

In arguing that Judge Westover was not disqualified to pass upon the motions filed in this case or to try the issues in the District Court, respondent makes the following points (Resp. Br. p. 6):

1. Appellant had waived the disqualification and consented to the trial of the case by Judge Westover.

2. It "is of no consequence" whether the provisions of Section 455, 28 U. S. C., are mandatory.

3. Judge Westover in his former official capacity as Collector of Internal Revenue was not "of Counsel" for respondent, nor did he have a "substantial interest" in the case.

As respondent states, the case of *United States v. Maher,* 88 Fed. Supp. 1007 (Me.), which is the *only* case in which Section 455 has been considered (Resp. Br. p. 10), is authority for appellant's contention that Section 455 compels a judge of a United States District Court to disqualify himself whenever he has been "of counsel" for either party in a case before him or has a "substantial interest" in the case. Section 455 is, therefore, mandatory to this extent, as urged by appellant. There can be no waiver of a disqualification by either or both parties, if the disqualification is mandatory. (48 C. J. S. 1101.)

Prior to the appointment of Judge Westover as Collector of Internal Revenue he was an attorney, being, in fact and as a matter of public record, a former Judge of the Superior Court of California in and for the County of Riverside. As Collector of Internal Revenue it was one of his duties to interpret and enforce the federal laws relating to income and other federal taxes. Being a "Collector" of taxes, he may surely be said to have had a "substantial interest" in the collection of the very taxes, collected during his term as Collector of Internal Revenue, the refunding of which forms the basis for this litigation. (Section 3641, *Internal Revenue Code.*)

II.

Respondent's summary of the second point is as follows (Resp. Br. p. 14):

> "The District Court was correct in holding and deciding that the taxpayers were taxable upon William P. Neil's share of the partnership's ordinary net income for 1946 regardless of events in subsequent years."

This is a most inexact statement of the main question involved which is, as set forth in Section 182, *Internal Revenue Code,* what is: "his (appellant's) distributive share of the ordinary net income" of the partnership, "whether or not distribution is made to him" (Resp. Br. App. p. 2).

Respondent relies, principally, upon *Bourne v. Commissioner,* 62 F. 2d 648 (C. A. 4th), certiorari denied, 290 U. S. 650, and upon *Faesy v. Commissioner,* 1 B. T. A. 350.

In the *Bourne* case, taxpayer simply chose to withdraw, from a law firm in which he was a partner, all of his share of the profits for the year 1926. His partners were solvent and were responsible to him for the payment of the undrawn portion of the profits upon demand by taxpayer. Clearly, this case is not in point here.

In the *Faesy* case, taxpayer Faesy, who was an employee of Suter & Co., a partnership, at the time, was made a partner in July, 1920, pursuant to an oral agreement under which he was to be credited with 10% of the profits of the firm. In May 1921, a new arrangement was made in writing. At the time of the Board of Tax Appeals hearing, Faesy had not collected from the partnership all of the credits due him but had made certain cash withdrawals which, it was conceded, were due him. In litigation pending in the New York State Courts at the time of the Board hearing, the Suter & Co. partnership had been held to be a legal partnership and Faesy to be a valid partner therein. The New York litigation was still in progress at the time of the Board hearing.

Similarly, *Curtis v. Commissioner,* 3 T. C. 648, cited by respondent, is simply authority for the correct statement that a partner could not postpone the payment of income taxes upon his share of the profits of a joint venture by accepting corporate stock as such share, in lieu of cash.

The case most similar to the Neil situation here is that of *Reinschmidt v. Commissioner,* 28 F. 2d 660 (C. C. A. 5th), which is discussed in Appellant's opening brief at page 17.

Respondent's urge that Mr. Neil must account for the income tax upon that portion of the partnership income accruing to him under the specific provisions of the partnership agreement, whether or not, Mr. Neil was legally entitled ever to receive such income. (Resp. Br. pp. 16-17.) The absurdity of the invoking of such a harsh and inequitable rule is apparent when the cases of *Wise v. Radis,* 74 Cal. App. 765, 242 Pac. 90, and *Del Rey Realty Co. v. Fourl,* 44 Cal. App. 2d 397, 112 P. 2d 649, are reexamined. These cases are discussed on pages 14 and 15, respectively, of appellant's opening brief. Under the theory of respondent (Resp. Br. p. 18), plaintiffs Wise and Del Rey Realty Co. must account for taxable income from joint ventures (classed as partnerships for purposes of federal income taxation), which they never received, or could receive, whereas defendants Radis and Fourl could enjoy a portion of their income from the joint ventures free of all income tax thereon, although they received such income, retained it, and were not accountable to plaintiffs Wise and Del Rey Realty Co. for it. (Section 10137 of the *Business & Professions Code* of the State of California, as quoted upon page 14 of appellant's opening brief.)

In *Republic Oil Refining Co. v. Granger* (D. C. Pa., June 21, 1951), 98 Fed. Supp. 921, the true rule as to the applicability of State laws to the subject of federal taxation is aptly stated as follows:

> "The local rule will be followed whenever the applicability of a federal revenue statute is dependent upon fact which can be interpreted only in accordance with State rules of property.
>
> "A thing which is within the letter of statute imposing a tax is not within the statute unless it is within intention of Congress."

It cannot be inferred that the intent of Congress in enacting Sections 180 to 183 of the *Internal Revenue Code* was to levy an income tax on the partner who did not receive income, due to the provisions of the laws of California (Sections 10130, 10137, of the *Business & Professions Code*), and to hold free of income taxes the partner who received and retained the income under the provisions of the laws of California.

Appellant assumes that respondent does not contend that both Neil and Owen are subject to income tax upon the same income.

In *Burnet v. Harmel,* 287 U. S. 103, 110, cited by respondent on page 18 of the brief, the pertinent holding of the Supreme Court was to the effect that the determination of federal income tax on gain from the sale of capital assets could not be controlled by a law of the State of Texas which unlike that of other states, regarded an oil and gas lease as a present sale of the oil and gas in place.

A nationwide scheme of taxation must be given a uniform application, citing *Weiss v. Weiner,* 279 U. S. 333, 337.

In *Morgan v. Commissioner,* 309 U. S. 78, 80, also cited by respondent on page 18, it was held that the terminology of a definition of a "special power" as applied to an appointment by a decedent, contained in the laws of Wisconsin, could not control the federal taxation of such a "special power."

The foregoing cases are obviously inapplicable to the facts of this case.

Referring to page 19 of respondent's brief *re* the "claim of right" doctrine, appellant again avers that Mr. Neil is taxable upon that portion of the partnership income for the years 1943, 1944, 1945 and 1946 which was "distributed" to Neil in the year 1946 (There were no distributions of income to Neil prior to the year 1946. [Tr. p. 21.]) After the income was distributed to Neil, he held it under a "Claim of right." Although Owen could have retained *all* of the partnership income under the provisions of the California law in that it was "distributive" under such law to Owen only, who was in possession of the income and might retain it, nevertheless Owen, prior to the receiving of advice of his Counsel in the California case of *Neil v. Owen,* Superior Court of Los Angeles County [Exs. 5-6], did "distribute" a substantial portion of the partnership income to Neil. The retained portion of the partnership income was held by Owen under a "Claim of right." *United States v. Lewis,* 71 S. Ct. 522; 340 U. S. 590; rehearing denied, 341 U. S. 923.

Conclusion.

For the foregoing reasons, as well as those stated in appellant's opening brief, appellants urge:

1. That the action of the District Court in denying appellant's motion to vacate the judgment be reversed and the case remanded to the District Court with instructions to grant a new trial before a District Judge other than Judge Harry C. Westover.

2. In the alternative, that the judgment of the District Court be reversed and the case remanded to the District Court with instructions to enter judgment in favor of appellants.

Respectfully submitted,

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